



Australian Energy Market Commission

CONSULTATION PAPER

NATIONAL ELECTRICITY AMENDMENT (APPLICATION PERIOD FOR CONTINGENT PROJECT REVENUE) RULE 2019

PROPONENT

Dr Kerry Schott AO

7 MARCH 2019

RULE

INQUIRIES

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ABOUT THE AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

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1 INTRODUCTION

On 20 February 2019, Dr Kerry Schott AO submitted a rule change request to the Australian Energy Market Commission (AEMC or Commission) that seeks to amend the relevant clauses of the National Electricity Rules (NER) so that they no longer prevent transmission and distribution network businesses from submitting a contingent project application to the Australian Energy Regulator (AER) in the 90 business days before the end of a regulatory year, except where that regulatory year is the last year of a regulatory control period.

The rule change request states that any incremental revenues approved by the AER in respect of a contingent project application submitted during the last 90 business day window of the regulatory year could not start to be recovered by the relevant network service provider until the second regulatory year that commences after the application is submitted.

This consultation paper has been prepared to facilitate public consultation on the rule change request and to seek stakeholder submissions.

This paper:

- provides a summary of, and background to, the rule change request
- identifies a number of questions and issues to facilitate consultation on this rule change request
- outlines the process for making submissions.

1.1 Background

1.1.1 Revenue approval - contingent project application

The economic regulatory regime in the NER allows for limited circumstances in which a network service provider's (NSP's) revenue allowance can be adjusted during a regulatory control period (generally, a period of five years). One way in which this can happen is through the contingent projects mechanism, as set out in clause 6.6A and 6A.8 of the NER.¹

The contingent project mechanism can be used where large discrete projects have already been identified as part of the revenue determination process that may or may not be required during the upcoming regulatory control period.

Contingent projects are not included in the ex-ante revenue allowance. However, the definition of the contingent projects and their accompanying trigger events form part of a NSP's final revenue determination by the AER. Trigger events usually include the successful completion of a regulatory investment test (for transmission or distribution as relevant).

Potential contingent projects can be identified by either transmission network service providers (TNSPs) or distribution network service providers (DNSPs) in their revenue proposals. The AER then reviews those proposals and determines whether to allow for the inclusion of the contingent projects in the revenue determination. Projects identified must:

- Be reasonably required to be undertaken to meet the capital expenditure objectives.

¹ Others include pass through events (clause 6A.7.3) and capital expenditure reopeners (clause 6A.7.1).

- Not be otherwise provided for in the forecast capital expenditure allowance under the revenue determination.
- Exceed either \$30 million or five per cent of the value of the maximum allowed revenue for the relevant TNSP or DNSP for the first year of the regulatory control period.

Following the occurrence of the trigger events during the regulatory period, the NSP then applies to the AER for an adjustment to their allowed revenue. The AER must then make a decision as to whether the trigger events for the contingent project have occurred. The AER must also determine the amount of capital and operating expenditure reasonably required to undertake the project and the impact of allowing such expenditure as revenue. The AER sets out the requirements on TNSPs and DNSPs in lodging applications and the obligations on the AER in assessing applications. Once the AER determines that the trigger events have been met, and the efficient amount of expenditure associated with the project, then the NSP's revenue determination is adjusted for the remaining regulatory years of the regulatory control period to reflect the project.

While the contingent project mechanism exists for TNSPs and DNSPs, it is relatively unusual for DNSPs to have many contingent projects (if at all). In contrast, TNSPs typically have a number of contingent projects identified in their revenue determinations. In particular, many of the group 1 and group 2 projects identified in the Integrated System Plan (ISP) have been identified in TNSP's revenue determinations as contingent projects.

For the contingent project trigger event to be satisfied for most transmission contingent projects that the AER has approved in recent revenue determinations, the AER will need to be satisfied that the RIT-T has been successfully completed before a TNSP submits a contingent project application. The AER determines this using the approach laid out in clause 5.16.6 of the NER.²

1.1.2 **Clauses 6A.8.2(b)(1) and 6.6A.2(b)(1)**

As noted above, when the pre-determined triggers are met during the regulatory control period, the NSP must then apply to the AER for assessment of the contingent project for the purposes of revenue adjustment.

Clauses 6.6A.2(b)(1) and 6A.8.2(b)(1) prohibit the DNSP and TNSP, respectively, from submitting a contingent project application within 90 business days prior to the end of a regulatory year.³

The rationale for the existence of these clauses is linked to charging. Transmission and distribution charges are set on a year by year basis, taking into account the allowed revenue. There are a number of steps that must be undertaken after contingent project revenues are approved and included in the allowed revenue before the associated transmission and distribution charges can be recovered in retail prices. For example, transmission charges must be included within distribution charges, and these must be notified to retailers before the end of the regulatory year. These steps take some time. The relevant clauses prevent a

² This process does not apply in distribution.

³ The regulatory year ends on 30 June for Queensland, NSW, ACT, Tasmania and South Australia, and 31 December for Victoria.

contingent project application being submitted after a point when it would be no longer possible to recover any incremental revenue in the following regulatory year.

1.1.3 **ESB work on actioning the ISP and related rule changes**

At the COAG Energy Council meeting on 10 August 2018, the Energy Security Board (ESB) was requested to report in December 2018 on:

- how the group 1 projects in the ISP could be delivered as soon as practicable
- how group 2 and 3 projects should be progressed
- how the ISP would be converted into an actionable strategic plan⁴

On 19 December 2018, the Energy Security Board provided a report to the COAG Energy Council outlining how the points listed above should be addressed.⁵ Responding to the report, the COAG Energy Council agreed on an approach, set out by the ESB, to deliver group 1 projects as soon as possible including rule changes to streamline regulatory processes. Ministers also tasked ESB to consider how these reforms could be applied to other priority projects such as the South Australia to New South Wales interconnector. The ESB will report back to COAG Energy Council by the end of March 2019 for a decision as soon as possible. Ministers noted that a rigorous cost benefit analysis will be an essential part of the process to ensure costs to consumers are minimised, and agreed that the ESB do more work on further measures to operationalise the ISP including regular updates and re-assessments of group 2 and 3 projects.⁶

Following this, Dr Kerry Schott AO submitted two rule change requests to the AEMC that seek to streamline the regulatory processes for several of the projects identified in the ISP. Under the NER, there are three regulatory processes that need to be undertaken by the AER after a regulatory investment test has been completed⁷:

- resolution of any disputes lodged in relation to the application of a regulatory investment test under clause 5.16.5
- at the request of the regulatory investment test proponent, make a determination that a preferred option identified through a regulatory investment test process conducted by the relevant transmission business satisfies the test under clause 5.16.6
- amend a transmission business' revenue determination for a contingent project when an application to do so is received under clause 6A.8.2.

Currently under the NER, these processes must be conducted one after the other. The rule change requests seek to allow:

4 COAG Energy Council, Meeting Communique, 10 August 2018.

5 Energy Security Board, Integrated System Plan - Action Plan, 20 December 2018. See: <http://www.coagenergycouncil.gov.au/publications/integrated-system-plan-action-plan>

6 COAG Energy Council, Meeting Communique, 19 December 2018, p.2.

7 These rule change requests relate to processes for specific transmission contingent projects. To note, there is no clause 5.16.6 determination equivalent for distribution.

- for the *Early implementation of ISP projects* rule change request,⁸ the dispute process, preferred option assessment and the revenue assessment to be conducted concurrently for upgrades to the Victoria-New South Wales interconnector (VNI) and Queensland-New South Wales interconnector (QNI) that are currently being considered⁹
- for the *ISP priority projects - SA energy transformation* rule change request,¹⁰ the preferred option assessment and the revenue assessment to be conducted concurrently for Project EnergyConnect.

These changes will save time in the regulatory process.

1.2 Issue raised in the rule change request

The rule change request states that, at the COAG Energy Council meeting on 19 December 2018, Ministers discussed and agreed on an approach to deliver ISP group 1 transmission projects identified in the Australian Energy Market Operator's ISP as soon as possible, including rule changes to streamline regulatory processes. Subsequent to that meeting, the potential for clause 6A.8.2(b)(1) to delay implementation of some of the ISP group 1 projects has been identified.

Through submissions to the *Early implementation of ISP priority projects* rule change request, as well as through informal discussions, TNSPs have identified that clauses 6.6A.2(b)(1) and 6A.8.2(b)(1) of the NER, which prohibit the DNSP and TNSP, respectively, from submitting a contingent project application within 90 business days prior to the end of a regulatory year, may delay time critical projects more generally. That is, they may delay the time at which NSPs get certainty as to revenue recovery for those projects.

QUESTION 1: ISSUES

- What are stakeholders' views on the issues raised by the proponent?
- Are there any other issues relevant to this rule change request that the AEMC should consider?

1.3 Proposed solution

The proposed rule change would amend the relevant clauses such that they:

- Would no longer prevent a contingent project application from being submitted in the 90 business days before the end of a regulatory year, except where that regulatory year is the last year of a regulatory control period, but

8 See: <https://www.aemc.gov.au/rule-changes/early-implementation-isp-priority-projects>

9 For QNI, see: <https://www.transgrid.com.au/what-we-do/projects/current-projects/ExpandingNSWQLDTransmissionTransferCapacity>; for VNI, see: <https://www.aemo.com.au/Electricity/National-Electricity-Market-NEM/Planning-and-forecasting/Victorian-transmission-network-service-provider-role/Regulatory-investment-tests-for-transmission>

10 See: <https://www.aemc.gov.au/rule-changes/isp-priority-projects-sa-energy-transformation>

- Would recognise that any incremental revenues approved by the AER in respect of a contingent project application submitted during the 90 business day window could not start to be recovered by the relevant NSP until the second regulatory year that commences after the application is submitted.

The rule change does not affect the timing of recovery of network charges, as shown in the below example in Box 1. Therefore, even though the rule change request would not affect when the NSP could recover incremental revenues approved in respect of a contingent project, it would potentially bring the AER consideration and approval of a contingent project forward three to four months. The proponent considers that this could be of benefit for a time critical project because it would give the relevant TNSP or DNSP greater certainty regarding the recovery of costs such that it could commence works on the project at an earlier stage.

BOX 1: EXAMPLE AND IMPLICATIONS OF THE PROPOSED RULE CHANGE

Take for example an NSP with its regulatory years commencing on 1 July. If the rule change were made, then for a contingent project application submitted to the AER on 10 May 2019, any incremental revenue approved by the AER relating to a contingent project could not be recovered in the 2019-20 regulatory year. However, the AER could still approve the revenues, and any incremental revenue approved by the AER would be recovered starting from the 2020-21 regulatory year.

The rule change would not affect the timing of recovery of network charges, because:

1. If the rule change is not made, the contingent project application could not be submitted until the 2019-20 regulatory year and the network charges could not start to be recovered until the 2020-21 regulatory year.
2. The rule change, if made, would specifically provide that the new network charges could not start to be recovered until the 2020-21 regulatory year, even if the contingent project application is submitted less than 90 business days before the start of the regulatory year.

Source: Dr Kerry Schott AO, Application period for contingent project revenue rule change request, 20 February 2019, pp.2-3.

While this concern has arisen in relation to transmission contingent projects, given that this clause applies equally to both TNSPs and DNSPs, the proponent considers that it would be desirable for the same arrangements to apply to both transmission and distribution in order to minimise the differences between the regimes.

The rule change request states that the proposed rule change is expected to allow the regulatory processes associated with contingent projects to be achieved faster, potentially resulting in quicker delivery of transmission or distribution projects. Where these projects are time critical, this would promote reliability and security of supply in the NEM as it would assist the TNSP or DNSP in starting (and therefore completing) a project in a more timely manner.

The rule change would have the benefit of allowing applications for contingent projects to be submitted earlier. The rule change request would likely come into effect on the day that the final determination is made. Therefore, this would enable a TNSP or DNSP to submit a contingent project revenue application to the AER in the period 2 May 2019 to 30 June 2019, potentially allowing any currently time-critical projects to be implemented in a more timely manner.

The rule change request does not include a proposed rule. Copies of the rule change request may be found on the AEMC website, www.aemc.gov.au.

QUESTION 2: PROPOSED SOLUTION

- Does the proposed rule address the issues stated by the proponent?
- Are there alternatives to the proposed rule that would more effectively address the issue stated by the proponent?
- Are there any unintended consequences that may arise from the removal of these clauses?

1.3.1

Application to the end of the regulatory period

The rule change request seeks to still maintain the restriction of a contingent project application not being submitted in the 90 business days before the end of a regulatory year for the last year of a regulatory control period. This is because in this instance there are no remaining years of the regulatory control period in relation to which revenue can be adjusted. In the example where a regulatory control period ends on 30 June 2023, if a contingent project was submitted within 90 business days before that date, then the revenue associated with that project will not start to be recovered until 1 July 2025, which will be the start of the second regulatory year in the next regulatory control period. Given that contingent projects are for those projects that are uncertain in timing within a current regulatory period, this appears inappropriate. In addition, in practical terms, it is likely that the contingent project would be included in the revenue proposal for the first year of the upcoming regulatory period. This would allow the NSP to start recovering the revenue straight away (from 1 July 2024).

However, there is a question about whether this restriction should also apply to the *penultimate* year of the regulatory period. Following on from the above example, the penultimate regulatory year commences on 1 July 2023. Should an NSP be allowed to submit a contingent project application in the 90 business days prior to that? There are pros and cons to consider:

- If NSPs are allowed to submit a contingent project application in the 90 business days prior to the penultimate year of the regulatory period, then the revenue will not start to be recovered until 1 July 2024, i.e. the first year of the next regulatory control period. TNSPs would gain revenue certainty over the project in the usual timeframes that the

AER takes to make a contingent project assessment. However, this may create challenges for the AER in terms of setting the next revenue determination.

- If NSPs are *not* allowed to submit a contingent project application in the 90 business days prior to the end of the penultimate year of the regulatory control period, then it would be expected that NSPs would include the project in their revenue proposals. NSPs have to submit their regulatory proposals 17 months before the end of the regulatory period. It would be expected that the investment would be reflected in that proposal. However, this would mean that the NSP would not have revenue certainty over the investment until the time that the final determination is made, which is obviously a longer period of time than that for a contingent project assessment.

QUESTION 3: APPLICATION TO THE END OF THE REGULATORY PERIOD

- Should the restriction about contingent projects not being submitted in the 90 business days before the end of a regulatory year, be maintained for the last year of a regulatory control period?
- Should the restriction about contingent projects not being submitted in the 90 business days before the end of a regulatory year, be maintained for the penultimate year of a regulatory control period?

1.4

Assessment framework

1.4.1

Achieving the NEO

Under the National Electricity Law (NEL) the Commission may only make a rule if it is satisfied that the rule will, or is likely to, contribute to the achievement of the national electricity objective (NEO).¹¹ This is the decision making framework that the Commission must apply.

The NEO is:¹²

to promote efficient investment in, and efficient operation and use of, electricity services for the longer term interests of consumers of electricity with respect to -

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system.

The AEMC considers that the relevant aspects of the NEO for this rule change request are the promotion of efficient investment in and use of electricity services with respect to the price, reliability and security of the supply of electricity, and reliability and security of the national electricity system. In determining whether the proposed rule is likely to promote the NEO, the Commission proposes to have regard to the following principles:

¹¹ Section 88 of the NEL.

¹² Section 7 of the NEL.

- **Making transmission and distribution investments at the right time:** A process which promotes making transmission and distribution investment in order to address system limitations in a timely way reduces the risk of price, reliability and/or security issues arising from investments that are too late in meeting the identified needs.
- **Minimising inefficient increases in regulatory cost:** Increased regulatory costs are ultimately borne by consumers in the form of higher prices. The benefit of any increased regulatory activity needs to outweigh the costs in order for the change to be efficient.
- **Promoting certainty for the market about project status:** A process that minimises uncertainty in the market, or provides certainty earlier, promotes efficient outcomes designed to meet the reliability needs of the national electricity system.

The assessment framework will consider if the benefits of the proposed rule outweigh the costs. The benefits of allowing a network business to submit a contingent project application to the AER at any stage in the regulatory year, except where that regulatory year is the last year of a regulatory control period, should outweigh the costs or risks of such a change in order for the Commission to make the rule.

QUESTION 4: ASSESSMENT FRAMEWORK

- Is the assessment framework appropriate for considering the proposed rule change request?
- Are there other relevant considerations that should be included in the assessment framework?

1.4.2

Making a differential rule

Under the Northern Territory legislation adopting the NEL, the Commission may make a differential rule if, having regard to any relevant MCE statement of policy principles, a different rule will, or is likely to, better contribute to the achievement of the NEO than a uniform rule. A differential rule is a rule that:

- varies in its term as between:
 - the national electricity system, and
 - one or more, or all, of the local electricity systems, or
- does not have effect with respect to one or more of those systems

but is not a jurisdictional derogation, participant derogation or rule that has effect with respect to an adoptive jurisdiction for the purpose of s. 91(8) of the NEL.

As the proposed rule relates to parts of the NER that apply in the Northern Territory, the Commission will assess the rule against additional elements required by the Northern Territory legislation.¹³

¹³ From 1 July 2016, the NER, as amended from time to time, apply in the NT, subject to derogations set out in regulations made under the NT legislation adopting the NEL. Under those regulations, only certain parts of the NER have been adopted in the NT. (See the AEMC website for the NER that applies in the NT.) National Electricity (Northern Territory) (National Uniform Legislation) Act 2015.

2 PROCESS FOR THIS RULE CHANGE

2.1 Treatment as a non-controversial rule change

The rule change proponent proposed the rule change request be treated as non-controversial in accordance with s. 96 of the NEL such that it could be processed on an expedited basis. This request has been made on the basis that the rule change request would not affect charging outcomes for consumers. It merely brings forward the time when the AER can potentially approve contingent project revenues.¹⁴

The Commission considers that the rule change request is a request for a non-controversial rule (and, as such, should be processed on an expedited basis) because the rule change is unlikely to have a significant impact on the national electricity market.¹⁵ This is because the proposed rule would not affect when an NSP could recover incremental revenues approved in respect of a contingent project, but would simply bring the AER consideration and approval of a contingent project forward three to four months if it is submitted in the last 90 business days of a regulatory year (except where that regulatory year is the last year of a regulatory control period, in which case a network business could not submit a contingent project application within the last 90 business days of the regulatory year).

Therefore, the rule change is not expected to result in any significant adverse impacts or costs on market participants. Any resourcing implications for the AER in implementing the rule change are not considered to be material.

Rule changes that are considered to be non-controversial may be processed under an expedited (faster) process under which there is only one round of consultation and the AEMC is required to publish its final rule determination within eight weeks of commencing the rule change process.¹⁶

The Commission has decided to use an expedited process to consider this rule change request provided that it does not receive any valid requests not to use the expedited process by 21 March 2019. To be valid, an objection should set out the reasons why the rule change request will have a significant impact on the national electricity market.

2.2 Key dates

Given the tightly defined nature of the issue, and the background information provided in the rule change request, this consultation paper is brief. Nevertheless, submissions are invited in relation to the matters identified above, and any other relevant issue.

The key dates for stakeholders in this process are as follows:

- Commencement of this rule change process: 7 March 2019
- Objections to an expedited process to be received by: 21 March 2019

¹⁴ Dr Kerry Schott AO, Application period for contingent project revenue rule change request, 20 February 2019, p.3.

¹⁵ See definition of non-controversial Rule in section 87 of the National Electricity Law.

¹⁶ The AEMC has published a notice under ss. 95 and 96 to commence and assess this rule change request as a non-controversial rule.

- Submissions to the proposal to be received by: 4 April 2019
- Final decision to be published under an expedited process by: 2 May 2019.

3 LODGING A SUBMISSION

The Commission invites requests not to make a rule under the expedited process and written submissions on this rule change proposal.

All enquiries on this project should be addressed to Elizabeth Bowron on (02) 8296 0619 or elizabeth.bowron@aemc.gov.au.

3.1 Lodging a request not to make a rule under an expedited process

Written requests not to make a rule under the expedited process in s. 96 of the NEL must include reasons for the request, and must be lodged with the Commission by 21 March 2019 online in accordance with the process specified below.

3.2 Lodging a submission to this rule change request

Written submissions on the rule change request must be lodged with the Commission by 4 April 2019 online in accordance with the process specified below.

Where practicable, submissions should be prepared in accordance with the Commission's guidelines for making written submissions on rule change requests.¹⁷ The Commission publishes all submissions on its website, subject to a claim of confidentiality.

3.3 Lodging online

Submissions, or requests not to make a rule under the expedited process, must be lodged online via the Commission's website, www.aemc.gov.au, using the "lodge a submission" function and selecting the project reference code ERC0265.

The request or submission must be on letterhead (if submitted on behalf of an organisation), signed and dated.

¹⁷ This guideline is available on the Commission's website www.aemc.gov.au.

ABBREVIATIONS

AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
COAG	Council of Australian Governments
Commission	See AEMC
DNSP	Distribution network service provider
ESB	Energy Security Board
ISP	Integrated System Plan
MCE	Ministerial Council on Energy
NEL	National Electricity Law
NEO	National electricity objective
NER	National Electricity Rules
NSP	Network Service Provider
TNSP	Transmission network service provider